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No. 98-103

In the Supreme Court of the United States

OCTOBER TERM, 1997

GHAITH R. PHARAON, PETITIONER

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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16 pp

QUESTIONS PRESENTED

1. Whether the civil penalty imposed upon petitioner violates the Excessive Fines Clause.

2. Whether the civil penalty imposed upon petitioner violates the Due Process Clause.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-19) is reported at 135 F.3d 148. The final decision of the Board of Governors of the Federal Reserve System (Pet. App. 20-55) is reported at 83 Fed. Res. Bull. 347.

JURISDICTION

The judgment of the court of appeals was entered on February 10, 1998. A petition for rehearing was denied on April 17, 1998. Pet. App. 209. A petition for a writ of certiorari was filed on July 15, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Bank Holding Company (BHC) Act of 1956 makes it unlawful for a company to become a bank

holding company except with the prior approval of the Board of Governors of the Federal Reserve System (Board). 12 U.S.C. 1842(a)(1). A company is a bank holding company if it has control over any bank through direct or indirect control of 25% or more of the bank's voting shares. 12 U.S.C. 1841(a)(1) and (2). Bank holding companies are required to file with the Board annual reports of their operations. 12 U.S.C. 1844(c), 3106(a); 12 C.F.R. 225.5(b), 225.2(c).

The Board may assess a civil money penalty against any "company which violates, and any individual who participates in a violation of," the BHC Act in an amount of "not more than $25,000 for each day during which such violation continues." 12 U.S.C. 1847(b)(1). For conduct prior to August 1989, the maximum was $1000 per day. 12 U.S.C. 1847(b)(1)(1988). In determining the amount of any penalty imposed, the Board is required to take into account:

> (i) the size of financial resources and good faith of the * * * person charged;
>
> (ii) the gravity of the violation;
>
> (iii) the history of previous violations; and
>
> (iv) such other matters as justice may require.

12 U.S.C. 1818(i)(2)(G); see 12 U.S.C. 1847(b)(2).

2. In the early 1980s, the Bank of Credit and Commerce International (BCCI), a commercial bank incorporated in Luxembourg, had operations in nearly 70 countries. Pet. App. 61. BCCI did not control a full service bank in this country. *Ibid.* When BCCI decided to acquire a bank in this country, it had enormous undisclosed losses. *Id.* at 64. BCCI knew that the Board would not approve its acquisition of a U.S. bank

if it discovered its precarious financial condition. *Id.* at 73. In order to conceal its role in the acquisition, BCCI decided to have a nominee acquire a U.S. bank on its behalf. *Ibid.*

BCCI identified Independence Bank in Encino, California, as a desirable acquisition target, and chose petitioner, a wealthy Saudi Arabian businessman, as its nominee in the acquisition. Pet. App. 73. Petitioner had served as BCCI's nominee in undisclosed acquisitions of other companies and had received profits of more than $150 million in dealings with BCCI as compensation for serving as a nominee. *Id.* at 73-74. Petitioner and BCCI entered into a written agreement under which petitioner would become the registered owner of 100% of Independence Bank's shares. *Id.* at 81. Under the agreement, however, petitioner would in fact be the beneficial owner of only 15% of those shares; the remaining 85% of the shares would be held for BCCI. *Ibid.* BCCI also provided petitioner with the $23 million needed to finance the purchase of the shares of Independence Bank in the form of "non-recourse loans" that petitioner was not required to repay. *Id.* at 89-90.

Petitioner applied to the FDIC and the California bank regulators for approval to acquire Independence Bank. Pet. App. 85. In his submissions to regulators, petitioner falsely represented that he was buying 100% of Independence Bank's shares in his own capacity and that he was investing his own funds to make the purchase. *Id.* at 86-87. Petitioner also failed to disclose his agreement with BCCI to hold shares on its behalf. *Id.* at 87. Based on the records before them, the FDIC and the California regulators approved the acquisition. *Id.* at 89.

After the acquisition, BCCI installed its own employee as the senior officer of Independence Bank, selected the majority of the bank's board of directors, and controlled its strategic policy. Pet. App. 113-115, 119-122, 132. BCCI also provided $17.5 million in additional capital to Independence Bank. *Id.* at 117-118. Between 1986 and 1990, BCCI submitted annual reports to the Board in which it was required to disclose the names of any banks in which it controlled more than 5% of the voting shares. *Id.* at 129-130. In each of those reports, BCCI failed to disclose that it controlled Independence Bank. *Id.* at 130. Petitioner knew of those reports. *Ibid.*

In July 1991, after years of extraordinary losses and pervasive fraud, BCCI was closed by regulators throughout the world. Pet. App. 126. In January 1992, Independence Bank was declared insolvent and closed by California regulators. *Ibid.*

3. In 1991, the Board began administrative enforcement proceedings against petitioner, charging him with participating in BCCI's continuing violations of the BHC Act's prior approval requirement and in BCCI's filing of false reports with the Board. Pet. App. 58-59. The Board sought to subject petitioner to a $37 million civil money penalty. *Id.* at 59. Petitioner was subsequently indicted by a federal grand jury in the District of Columbia for his role in the purchase of Independence. *Id.* at 4. He was also indicted by a federal grand jury in Florida and a state grand jury in New York for his participation in other BCCI-related transactions. Petitioner did not respond to the criminal charges. From his home in Saudi Arabia, and acting through counsel, however, petitioner sought a hearing on the Board's charges. *Ibid.*

Following a hearing at which petitioner appeared only through counsel, an Administrative Law Judge (ALJ) issued a decision finding that petitioner had committed all the violations charged and recommending that the Board impose a $37 million civil money penalty. Pet. App. 56-189. In determining the amount of the recommended penalty, the ALJ first calculated the maximum civil money penalty assessable under the BHC Act for petitioner's violations as $111,595,000. *Id.* at 163. The ALJ then considered other factors, including those specifically identified by 12 U.S.C. 1818(i)(2)(G). *Id.* at 164-176. The ALJ found that petitioner's net worth is "almost half-a-billion dollars," *id.* at 168, that petitioner knew that he was violating the banking laws, *id.* at 169, that petitioner's violations were "especially grave" since regulators "were reassured by [his] extraordinary personal wealth," *id.* at 170, and that petitioner violated a "series of laws" and made "multiple false statements" in connection with the acquisition of Independence, *id.* at 174. The ALJ also found that, as a result of the conduct of BCCI and petitioner, "BCCI suffered more than $40 million in losses," and "Independence Bank eventually failed." *Id.* at 187. The ALJ therefore concluded that a $37 million penalty was "in line with the gravity of the offenses, the intentional nature of the actions, the attempts to conceal the nature of the transactions, the expected levels of profit and the realities of loss." *Id.* at 184.

The Board adopted the ALJ's recommended decision. Pet. App. 20-52. The Board explicitly concurred in the ALJ's findings and reasoning with respect to the amount of the civil money penalty. *Id.* at 35.

4. The court of appeals affirmed the Board's orders. Pet. App. 1-19. The court of appeals held that, because the Board had weighed the factors set forth in the BHC

Act and had found that petitioner's fine was in line with the gravity of the offenses, the intentional nature of the actions, and the attempts to conceal the nature of the transactions, there was "nothing arbitrary or capricious in the Board's selection of the penalty." *Id.* at 15. The court also noted that the maximum civil money penalty authorized by the Act was more than three times the amount actually assessed. *Ibid.*

The court of appeals also held that the penalty imposed on petitioner did not violate the Excessive Fines Clause of the Eighth Amendment. Pet. App. 15-16. The court concluded that the Excessive Fines Clause requires a court to consider "the value of the fine in relation to the offense." *Id.* at 15. Reviewing that issue de novo, the court held that there was no Eighth Amendment violation. *Id.* at 16. Relying on the same considerations that led it to conclude that the penalty was not arbitrary or capricious for purposes of review under the Administrative Procedure Act (APA), 5 U.S.C. 701 *et seq.*, the court held that "the penalty is proportional to [petitioner's] violation." *Ibid.*

The court of appeals also held that the penalty was not imposed in violation of the notice component of the Due Process Clause. Pet. App. 16. The court explained that petitioner "cannot claim that he lacked constitutionally adequate notice" when the assessed penalty falls far below the statutory maximum. *Ibid.*

ARGUMENT

1. Petitioner contends (Pet. 12-16) that the holding below that the fine imposed on petitioner does not violate the Excessive Fines Clause conflicts with *United States* v. *Bajakajian*, 118 S. Ct. 2028 (1998). That contention is without merit and does not warrant review.

In *Bajakajian*, the Court held that the Excessive Fines Clause is violated if a fine "is grossly disproportional to the gravity of a defendant's offense." 118 S. Ct. at 2036. The Court rejected a principle of "strict proportionality," reasoning that "judgments about the appropriate punishment for an offense belong in the first instance to the legislature," and that "any judicial determination regarding the gravity of a particular criminal offense will be inherently imprecise." *Id.* at 2037. The Court also held that, while factual findings of a lower court must be accepted unless clearly erroneous, an appellate court must review the issue of proportionality de novo. *Id.* at 2037 & n.10.

The decision below is fully consistent with *Bajakajian*. In particular, the court in this case held that the Excessive Fines Clause requires a court to consider "the value of the fine in relation to the offense." Pet. App. 15. The court of appeals then examined that issue de novo, and concluded that the penalty imposed on petitioner was "proportional to his violation." *Id.* at 16.

Petitioner's principal contention (Pet. 12) is that the decision below conflicts with *Bajakajian* because the court offered no rationale for its conclusion that the penalty imposed on petitioner was proportional other than that the penalty was below the statutory maximum. That contention, however, is based on a misreading of the court's decision. In finding that the penalty imposed on petitioner is proportional to his offense, the court below expressly relied on the Board's findings under the factors set forth in 12 U.S.C. 1818(i)(2)(G), not on the relationship of the fine to the statutory maximum. Pet. App. 15-16. The court specifically explained that, "[a]fter weighing the mitigating factors set forth in 12 U.S.C. § 1818(i)(G)(i)-(iv)—'(i) the size of financial resources and good faith of

the . . . person charged; (ii) the gravity of the violation; (iii) the history of previous violations; and (iv) such other matters as justice may require—the Board found the penalty 'in line with the gravity of the offenses, the intentional nature of the actions, [and] the attempts to conceal the nature of the transactions.'" *Id.* at 15. The court noted that the penalty was well below the statutory maximum only after it had already concluded, based on the Board's findings, that the penalty was proportional. *Id.* at 16 ("As we have already indicated in rejecting [petitioner's] APA challenge, the penalty is proportional to his violation and well below the statutory maximum.").

Petitioner contends (Pet. 15) that the conduct at issue in this case is comparable to the reporting violation at issue in *Bajakajian*, and that the substantial penalty imposed on him is therefore grossly disproportional to his offense. Petitioner's conduct, however, is not remotely comparable to the conduct at issue in *Bajakajian*.

Bajakajian was convicted of willfully failing to report the otherwise legal removal of currency from the United States on a single occasion, and was subject to a forfeiture of the entire $357,144 that he had failed to report. The "violation was unrelated to any other illegal activities. The money was the proceeds of legal activity and was to be used to repay a lawful debt." *Bajakajian*, 118 S. Ct. at 2038. Bajakajian was not a money launderer, drug trafficker, or tax evader, and therefore did not "fit into the class of persons for whom the statute was principally designed." *Ibid.* The harm caused by Bajakajian's conduct was also "minimal." *Id.* at 2039. It "affected only one party, the Government," and, since there was no fraud or revenue loss, the

impact on the United States was "relatively minor." *Ibid.*

The situation here is entirely different. Petitioner helped to conceal major and continuing substantive violations of the banking laws. Had petitioner been truthful, the government would have learned of BCCI's illegal control of Independence Bank long before it did and could have acted to prevent its collapse. Pet. App. 132. Instead, Independence, a federally insured bank, became insolvent and was closed, requiring the government to repay investors and to seek recoupment from BCCI. *Id.* at 126.[1] In addition, BCCI's $40.5 milion investment in Independence Bank became worthless when Independence Bank failed, subjecting BCCI and its world-wide depositors to a substantial risk of serious losses. *Id.* at 187.[2] Finally, petitioner expected to

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[1] Independence Bank had more than $575 million in assets and was the largest state-chartered bank in California to fail. 1992 FDIC Ann. Rep. 39. The FDIC paid more than $525 million to insured depositors of the Bank at an estimated cost to the FDIC of approximately $164 million. *Id.* at 173-174. As a result of a subsequent criminal forfeiture action against BCCI, the United States was able to recoup the cost of paying the insured depositors of Independence Bank. *United States* v. *BCCI Holdings (Luxembourg), S.A.*, 46 F.3d 1185, 1187 (D.C. Cir.), cert. denied, 515 U.S. 1160 (1995). At the time of the Bank's closing, however, there was no assurance that any of the FDIC's costs could be recovered.

[2] Contrary to petitioner's contention (Pet. 8), the amendment to the court of appeals' opinion deleting the reference to BCCI's unrecoverable investment in Independence Bank does not undermine the Board's findings concerning BCCI's potential losses. The court amended its opinion after petitioner filed a petition for rehearing in which he informed the court that he was taking the position in ongoing litigation that BCCI had recovered its investment in Independence Bank. C.A. Reh'g Pet. at 8 & n.6. Regardless of whether BCCI eventually recovered its investment

realize substantial profits from his illegal activity. *Id.* at 74, 184. Before the acquisition of Independence, petitioner had already engaged in transactions with BCCI in which he ultimately earned more than $150 million, and those transactions were intended to be "indicative of future opportunities to be offered to [petitioner] by BCCI." *Id.* at 74. Those circumstances fully support the court's conclusion that the penalty imposed on petitioner is not grossly disproportional in relation to his offense. That is especially true in light of the fact that petitioner has a net worth of a "half-a-billion dollars." *Id.* at 168. In any event, the court of appeals' fact-bound proportionality determination does not warrant review.

2. Petitioner's contention (Pet. 16-23) that the penalty imposed on him violates the Due Process Clause is equally without merit. Petitioner argues (Pet. 17-18) that the penalty violates the principle of proportionality that is embodied in the Due Process Clause. As this Court held in *Graham* v. *Connor*, 490 U.S. 386, 395 (1989), however, when a particular amendment "provides an explicit textual source of constitutional protection against [a particular sort of] governmental conduct, that Amendment, not the more generalized notion of 'substantive due process,' must be the guide for analyzing these claims." See also *County of Sacramento* v. *Lewis*, 118 S. Ct. 1708, 1714-1715 (1998). Because the Excessive Fines Clause provides

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in Independence Bank, at the time that Independence was closed, BCCI's potential losses were substantial, and that substantial risk of loss was appropriately considered by the Board in imposing its penalty on petitioner. Cf. *TXO Production Corp.* v. *Alliance Resources Corp*, 509 U.S. 443, 460 (1993) (plurality opinion) (in assessing punitive damages, "[i]t is appropriate to consider the magnitude of the *potential harm*") (emphasis in original).

an explicit textual source of protection against excessive civil penalties, a due process inquiry into whether such a penalty is excessive is inappropriate.

BMW of North America, Inc. v. *Gore*, 517 U.S. 559 (1996), relied on by petitioner, does not suggest otherwise. That case involved the question of the extent to which the Due Process Clause imposes limits on the imposition of excessive punitive damages awards in a civil case between private parties. Because the Excessive Fines Clause does not apply to such awards, *Browning-Ferris Indus. of Vt., Inc.* v. *Kelco Disposal, Inc.*, 492 U.S. 257 (1989), a due process proportionality inquiry was not precluded under *Graham*.

Nor does the imposition of the award in this case violate the due process principle that a person must receive adequate notice "of the severity of the penalty that a [government] may impose." *BMW*, 517 U.S. at 574. Here, during the period from 1985 through 1991 when petitioner engaged in the violations at issue, the text of the BHC Act placed him on notice that he could be subject to a civil penalty of up to $1000 per day before August 1989, 12 U.S.C. 1847(b)(1)(1988), and up to $25,000 for each day a violation continued thereafter, 12 U.S.C. 1847(b)(1). As the court of appeals explained, because petitioner's "assessed penalty falls far below the statutory maximum, [petitioner] cannot claim that he lacked constitutionally adequate notice." Pet. App. 16.

Petitioner errs in suggesting (Pet. 18) that notice may be supplied only by the penalties actually imposed in comparable cases. Under *BMW*, notice may be furnished by "civil penalties *authorized or* imposed in comparable cases." *BMW*, 517 U.S. at 575 (emphasis added). Because "no two cases are truly identical," *TXO Production Corp.*, 509 U.S. 443, 457 (1993) (plural-

ity opinion), an authorized sanction is "not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases." *Butz* v. *Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973).[3]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[3] Petitioner's reliance on the less severe penalties imposed in *Intramericas Investments, Ltd.* v. *Board of Governors*, 111 F.3d 376, 381 (5th Cir. 1997), and *W.C. Long* v. *Board of Governors*, 117 F.3d 1145, 1150 (10th Cir. 1997), is particularly unpersuasive. The penalties in those cases were assessed years after petitioner engaged in the violations at issue here, and therefore could not have provided notice as to the likely penalties for his conduct. In any event, neither of those cases involved the failure of the bank unlawfully acquired.